

UNITED STATES BANKRUPTCY COURT  
NORTHERN DISTRICT OF NEW YORK

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IN RE:

JAMES P. HAMMOND

CASE NO. 00-65516

Debtor

Chapter 7

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JOAN CATALINI, JAMES RAITE, J. PHILLIP  
SPAID, IND. and as TRUSTEE OF THE  
VIRGINIA REINLANDER TRUST and  
JUDITH SPAID

Plaintiffs

vs.

ADV. PRO. NO. 99-80048A

JAMES P. HAMMOND

Defendant

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APPEARANCES:

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Hon. Stephen D. Gerling, Chief U.S. Bankruptcy Judge

**MEMORANDUM-DECISION, FINDINGS OF FACT,  
CONCLUSIONS OF LAW AND ORDER**

Presently pending before the Court is an adversary proceeding filed by Joan Catalini, James Raite, J. Philip Spaid, Individually and as Trustee of the Virginia Reinlander Trust and Judith Spaid (“Plaintiffs”), on February 4, 1999, seeking a denial of discharge and nondischargeability of certain debts pursuant to §§ 727(a)(2), 523(a)(2), (4) and (6) of the Bankruptcy Code, 11 U.S.C. §§ 101-1330 (“Code”). On November 20, 2001, James P. Hammond (“Defendant”) filed a motion in this adversary proceeding, seeking summary judgment, dismissal of Plaintiffs’ complaint, “discharge” of Plaintiffs as creditors in Defendant’s bankruptcy case, an order in favor of defendant pursuant to his counterclaim and attorneys’ fees. On November 30, 2001, Plaintiffs filed a cross-motion supporting dismissal of the adversary proceeding, requesting summary judgment in their favor dismissing Defendant’s counterclaim and an order directing Defendant to pay the costs and attorneys’ fees related to this motion. The Court initially heard oral argument on December 4, 2001, in Syracuse, New York. At its regular motion term on February 5, 2002, the Court afforded the parties the opportunity to file supplemental memoranda of law. The matter was taken under submission for decision on February 14, 2002.

### **JURISDICTIONAL STATEMENT**

The Court has core jurisdiction over the parties and subject matter of this adversary proceeding pursuant to 28 U.S.C. §§ 1334(b), 157(a), (b)(1) and (b)(2)(I).

### **FACTS**

According to Defendant, he has been employed as a stockbroker for more than twenty-seven years. *See* Defendant's Supplemental Affidavit, filed January 31, 2002, at ¶ 2. A report filed with the Court from the Central Registration Depository ("CRD") of the National Association of Securities Dealers, Inc. ("NASD") sets forth Defendant's employment history relevant to the disputes at issue.<sup>1</sup> According to the CRD, Defendant was employed as a stockbroker at Paine Weber Incorporated ("PaineWeber") from January 1989 to March 1994. *See* Amended Supplemental Affidavit of Plaintiffs' Attorney, Beth A. Brownson ("Brownson"), filed January 4, 2002, at Exhibit 1. The CRD indicates that Defendant subsequently worked for Prudential Securities Incorporated ("Prudential") from March 1994 to May 1997. *See id.* From June 1997 to August 1999, he was employed by First Albany Corporation ("First Albany"). *See id.*

According to Plaintiffs, during the periods in which Defendant was employed by PaineWeber and Prudential, he engaged in improper and unethical conduct regarding their respective investments.<sup>2</sup> *See* Verified Statement of Claim before the NASD, annexed to Plaintiffs' adversary proceeding complaint at Exhibit 1, at ¶ 8. Consequently, Plaintiffs filed a Verified

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<sup>1</sup>For purposes of clarification, the Court understands the NASD to be a self-regulatory organization for the securities industry. The NASD develops rules and regulations, conducts regulatory reviews of members' business activities, disciplines violators, provides arbitration and mediation services, and regulates securities markets. The CRD is a computerized system wherein the NASD maintains employment qualifications and disciplinary histories of more than 400,000 securities industry professionals who deal with the public.

<sup>2</sup>Plaintiffs assert that the following were clients of PaineWeber: Joan Catalini; Philip Spaid, Individually and as Trustee of the Virginia Reinlander Trust, and Judith Spaid. Clients of Prudential were: Joan Catalini; James Raite, and Philip Spaid, Individually and as Trustee of the Virginia Reinlander Trust.

Statement of Claim against Defendant, PaineWeber and Prudential before the NASD on or about May 13, 1998.<sup>3</sup> Among the causes of action asserted by Plaintiffs were the violation of federal securities law, fraudulent misrepresentation, negligence, breach of contract, breach of fiduciary duty, violation of New York General Business Law section 349(a), violation of § 12(a)(2) of the Securities Act, fraud, negligent misrepresentation, and theft. *See* Arbitration Decision annexed to Defendant's Motion, filed November 20, 2001, at Exhibit A. In his answer to the complaint before the NASD, Defendant asserted a counterclaim based on false accusations of theft, false accusations of unauthorized withdrawals and character defamation. *See id.*

While the arbitration proceedings were pending before the NASD, Defendant filed a petition on November 23, 1998, for relief under chapter 7 of the Code. On February 4, 1999, Plaintiffs commenced the within adversary proceeding against Defendant. The adversary complaint sought a denial of Defendant's discharge and nondischargeability of certain debts pursuant to the allegations set forth in the Verified Statement of Claim before the NASD. In the answer, Defendant again asserted a counterclaim based on his assertion that the various claims against him pursuant to the Code, the Securities Exchange Act, The New York General Business Law, New York Debtor and Creditor Law, New York Estates Powers and Trust Law and New York Criminal Law were "malicious, wanton, without basis in fact, frivolous, intended to needlessly increase the costs of litigation, harassing and [were] without evidentiary support . . . ." Defendant's Adversary Proceeding Answer, filed March 5, 1999, at ¶ 10. Plaintiffs subsequently sought relief from the automatic stay to proceed with the NASD arbitration

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<sup>3</sup>The NASD offers a forum of arbitration and mediation for the resolution of monetary and business disputes between and among investors, securities firms and individual registered employees of those firms.

proceedings. By Order dated April 12, 1999, this Court granted them permission to proceed with arbitration against Defendant to the extent that any award could be collected from PaineWeber or Prudential.

Before the hearings in the arbitration proceedings commenced, Paine Weber entered a settlement agreement with Plaintiffs. *See* Arbitration Decision annexed to Defendant's Motion, at Exhibit A. Consequently, PaineWeber did not participate in the arbitration hearings. *See id.* On the final day of the hearings, counsel for Plaintiffs and Prudential informed the arbitration panel that all of Plaintiffs' claims against Defendant and Prudential were settled. *See id.* Defendant, however, refused to enter the settlement agreement to the extent that it compromised his right to pursue the counterclaim he had asserted in the arbitration proceedings. *See id.* Thus, the arbitration decision, rendered on or about December 1, 2000, only addressed Defendant's counterclaim.<sup>4</sup> Without setting forth any statement of facts or discussion in its decision, the arbitration panel awarded Defendant \$100 as compensatory damages to be paid by Plaintiff Joan Catalini. *See id.* All of Defendant's other requests for relief, including punitive damages, were denied. *See id.*

As a result of the settlement agreements with Paine Weber and Prudential in the arbitration proceedings, Plaintiffs sought to discontinue this adversary proceeding against Defendant. To that end, Brownson sent a proposed stipulation of discontinuance to Defendant's attorney, Samuel J. Costa ("Costa"), on June 15, 2001, and again on September 6, 2001. Defendant refused both

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<sup>4</sup>The decision of the arbitration panel only addressed Defendant's counterclaim against Joan Catalini. Documents have been filed with the Court indicating that the counterclaim as it pertained to Judith Spaid and J. Phillip Spaid was resolved by mediation and resulted in no financial recovery from those parties. No information has been provided regarding the resolution of the counterclaim asserted against James Raite.

times to discontinue the adversary proceeding because he wished to preserve his counterclaim.

In pursuance of the findings on his counterclaim before the arbitration panel, Defendant filed a motion in this adversary proceeding on November 20, 2001, seeking to dismiss Plaintiffs' complaint, discharge Plaintiffs as creditors in his bankruptcy case and to direct an award in his favor pursuant to his counterclaim. Because they were unable to obtain a stipulation of discontinuance from Defendant, Plaintiffs filed a cross-motion November 30, 2001. They requested summary judgment dismissing their adversary proceeding claims including Defendant's counterclaim.

### ARGUMENTS

According to Plaintiffs, Defendant's counterclaim was fully resolved in the proceedings before the NASD. Defendant signed an agreement to mediate with Plaintiffs Judith Spaid and J. Phillip Spaid. That mediation produced no recovery for Defendant pursuant to his counterclaim. Plaintiffs further argue that the arbitration award of \$100 to be paid by Plaintiff Joan Catalini fully resolved the counterclaim. He had an opportunity at that time to participate, and as a result, he is now barred by the doctrine of *res judicata* from re-litigating that claim. Additionally, Plaintiffs assert that Defendant's counterclaim for libel or slander is without merit because all statements made in Plaintiffs' complaint are immune from liability as statements made in the context of litigation.<sup>5</sup> The final argument set forth by Plaintiffs relates to Defendant's alleged damages.

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<sup>5</sup>Although Defendant's counterclaim in the NASD arbitration asserted character defamation, his counterclaim in this adversary proceeding did not. *Compare* Arbitration Decision annexed to Defendant's Motion, filed November 20, 2001, at Exhibit A, *with* Defendant's

Defendant asserts that, as a result of Plaintiffs' commencement of this adversary proceeding, he was terminated from his employment with Prudential and has subsequently been unable to secure another position as a stock broker. According to Plaintiffs, Defendant has not shown that his inability to find employment in his field of expertise is the direct result of Plaintiffs' adversary proceeding complaint. Plaintiffs assert that Defendant's employment with PaineWeber and Prudential terminated prior to the commencement of this adversary proceeding. They further state that Defendant's employment with First Albany ended after the adversary proceeding complaint was filed, but they argue that their actions could not have caused his termination because he left voluntarily. Finally, they reference letters from a potential employer filed by Defendant, denying Defendant an offer of employment due to the multiple pending arbitration proceedings against him. Plaintiffs note that the letter is silent regarding the adversary proceeding and is insufficient to form a causal connection between this action and Defendant's inability to secure a position as a stockbroker. They now seek to voluntarily discontinue the adversary proceeding, and they request a dismissal of Defendant's counterclaim.

Defendant agrees that Plaintiffs' adversary complaint should be dismissed, but he does not wish to stipulate to discontinue his counterclaim. He argues that his practice as a stockbroker for over twenty-seven years was detrimentally affected by the commencement of this adversary proceeding. According to Defendant, the allegations set forth in Plaintiffs' adversary complaint were without basis in fact and were intended to harass or intimidate him. He further asserts that all of the NASD arbitration claims were resolved, either by settlement or the decision of the

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Adversary Proceeding Answer, at ¶ 10. Consequently, the Court does not consider any arguments regarding libel, slander or defamation herein.

arbitration panel, and there were no adverse findings against him. Defendant states that Plaintiffs' causes of action in this adversary proceeding are the same as those set forth in the Verified Statement of Claim filed in the NASD arbitration proceedings. Because all of the claims were resolved by the arbitration proceedings, *res judicata* applies to preclude Plaintiffs from arguing those same resolved matters before this Court. In contrast, Defendant argues that his counterclaim in this adversary proceeding differs from the counterclaim asserted in his answer to the NASD complaint. According to him, he could not have asserted the adversary proceeding counterclaim in the arbitration proceedings because the counterclaim in the adversary proceeding is dependant on the resolution of the NASD proceedings. Thus, Defendant argues that *res judicata* is a bar to the re-litigation of Plaintiffs' claims before this Court, but it does not preclude a determination of Defendant's counterclaim.

## **DISCUSSION**

### Defendant's Motion for Summary Judgment

Defendant seeks a dismissal of Plaintiffs' complaint in this adversary proceeding, and Plaintiffs support his request.<sup>6</sup> *See* Brownson's Affirmation in Opposition to Defendant's Motion for Summary Judgment, filed November 30, 2001, at ¶ 4. In the NASD arbitration proceedings, Plaintiffs were able to recover on their claims against Paine Weber and Prudential because PaineWeber and Prudential reached settlement agreements with them. Consequently, Plaintiffs

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<sup>6</sup>Plaintiffs and Defendant all support the dismissal of the adversary proceeding complaint. However, Plaintiffs seek a dismissal of the entire adversary proceeding, including Defendant's counterclaim. Defendant requests that the counterclaim be preserved.

do not wish to pursue the nondischargeability of their claims or the denial of Defendant's discharge. However, the Court recognizes a potential right of PaineWeber and Prudential, pursuant to Code § 509(a), to be subrogated to Plaintiffs' claims in this adversary proceeding.<sup>7</sup> Although the issue of subrogation is not presently before the Court, a dismissal of the instant adversary proceeding could adversely impact the interests of PaineWeber and Prudential, who were not noticed with the motions to dismiss. Thus, Paine Weber and Prudential must be afforded an opportunity to be heard regarding their possible rights of subrogation before a dismissal of the adversary proceeding is granted. Consequently, PaineWeber and Prudential will have forty-five (45) days from the date they are served with this Memorandum-Decision and Order to file a motion with the Court and be heard on the issue of subrogation.<sup>8</sup> Should the forty-five day period expire without an attempt by either PaineWeber or Prudential to preserve its subrogation rights, then the adversary proceeding complaint will be deemed dismissed without further application to

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<sup>7</sup>Code § 509(a) permits "an entity that is liable with the debtor on, or that has secured, a claim of a creditor against the debtor, and that pays such claim, [to be] subrogated to the rights of such creditor to the extent of such payment."

<sup>8</sup>Though the Court is preserving the rights of Paine Weber and Prudential to present arguments in favor of their ability to be subrogated to Plaintiffs' claims in this adversary proceeding, no position is being taken at this time regarding the actual existence of their subrogation rights.

the Court.<sup>9 10</sup>

### Plaintiffs' Cross-Motion for Summary Judgment

Plaintiffs seek an order granting summary judgment dismissing Defendant's counterclaim. Defendant's counterclaim in this adversary proceeding asserts that Plaintiffs' claims against him were "malicious, wanton, without basis in fact, frivolous, intended to needlessly increase the costs of litigation, harassing and [were] without evidentiary support . . . ." Pursuant to New York law, Defendant's counterclaim is not a properly asserted claim in this adversary proceeding because it is contingent upon the claims asserted by Plaintiffs, and, therefore, it is premature. *See Brown v. Stone*, 66 F. Supp.2d 412, 428-29 (E.D.N.Y. 1999) (analyzing New York law regarding contingent counterclaims and concluding that "[a] counterclaim cannot be contingent, it must allege a viable cause of action) (citations omitted); *Sasso v. Corniola*, 154 A.D.2d 362, 363, 545 N.Y.S.2d 839 (2d Dep't 1989) (finding that defendant's counterclaim, which asserted that

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<sup>9</sup>In addition to his request for a dismissal of Plaintiffs' action, Defendant also seeks summary judgment directing Plaintiffs to be "discharged" as creditors in his bankruptcy case, an award in his favor pursuant to his counterclaim and an award of attorneys' fees. While the Court is unaware of any procedure to "discharge" a creditor other than pursuant to an objection to that creditor's claim filed under Code § 502, the Court finds that Plaintiffs cannot be "discharged" as creditors because their status is necessary to preserve the potential subrogation claims of PaineWeber and Prudential. Additionally, the evidence before the Court does not support an award of attorneys' fees in Defendant's favor. Defendant's counterclaim is discussed *infra*.

<sup>10</sup>Federal Rule of Bankruptcy Procedure 7041 requires that a complaint objecting to the debtor's discharge "shall not be dismissed at the plaintiff's instance without notice to the trustee, the United States trustee, and such other persons as the court may direct . . ." The Court notes that Defendant's motion herein was served on both the case trustee, Michael Balanoff, Esq., and the United States Trustee, while the Plaintiffs' cross-motion was served on Trustee Balanoff, who Plaintiffs mistakenly believed was also the United States Trustee. Neither Trustee Balanoff nor the United States Trustee has filed any opposition to either motion. Thus, the Court concludes that Rule 7041 has been complied with.

plaintiff's action was frivolous, commenced in bad faith and an attempt to intimidate defendant sounded in malicious prosecution and was not properly interposed in the "very civil action that was allegedly instituted wrongfully").

The Court of Appeals for the Second Circuit addressed a similar issue in *Harris v. Steinem*, 571 F.2d 119, 124 (2d Cir. 1978). *Harris*, though not implicating a bankruptcy, involved allegations against the defendants of various securities law violations. *See Harris*, 571 F.2d at 121. The *Harris* defendants counterclaimed for libel based on the complaint itself, "which was alleged to have been 'brought maliciously,'" and on subsequent statements made by the plaintiff. *Id.* At the district court level, the plaintiff's claim was dismissed for her repeated failure to appear for a court-ordered deposition. *See id.* The district court judge also dismissed the counterclaim, concluding its decision to be a discretionary dismissal of a compulsory counterclaim. *See id.* On appeal, the Second Circuit reevaluated the district court's characterization of the counterclaim as compulsory and concluded that it was more properly designated as permissive. *See id.* at 125. The analysis by the Second Circuit incorporated language of the district court decision which stated that "the counterclaim, while artfully drafted, in essence is a claim for malicious prosecution." *Id.* at 124. The Second Circuit further quoted the district court decision stating that "[a] claim in the nature of malicious prosecution, which arises out of the bringing of the main action, generally cannot be asserted either as a compulsory or a permissive counterclaim, since such a claim is premature prior to the determination of the main action." *Id.* (emphasis in original) (citations omitted). Because the counterclaim was deemed premature and permissive, it could properly be dismissed because there was no independent jurisdiction to render a determination. Two "strong policy reasons" were noted in support of this result. First is the "postponement of

suits that will ordinarily not arise if plaintiff wins that main action.” *Id.* Second is the “avoidance of the ‘dangerous potentialities of counterclaims (in the nature of) malicious prosecutions as a defensive strategem [sic].”” *Id.* (citation omitted). Finally, the Second Circuit concluded that the defendants would not be left without a remedy upon the dismissal of their counterclaim because it was based on malicious prosecution, libel and slander, and such matters are best decided by state courts. *See id.*

Like the counterclaim asserted by the defendants in *Harris*, the Defendant’s counterclaim in the matter *sub judice* is premature in this adversary proceeding. Consequently, it must be dismissed. Additionally, dismissal is proper because the counterclaim is aptly designated permissive. Finally, the Court concludes that dismissal of Defendant’s counterclaim without prejudice does not impair his right to seek relief in another forum.

Independent of the conclusions based on the *Harris* analysis, the Court also finds that Defendant’s counterclaim must be dismissed for lack of jurisdiction. First, the counterclaim is not asserted pursuant to any express Code provision.<sup>11</sup> Rather, it is based on rights created by state law. Second, the counterclaim is not property of Defendant’s bankruptcy estate because it had not arisen at the time Defendant’s bankruptcy case was commenced. *See* Code § 541(a)(1); *In re Bobroff*, 776 F.2d 797, 803 (3d Cir. 1985) (explaining that causes of action accruing post-petition in a chapter 7 liquidation are generally not property of bankruptcy estate). The counterclaim is based on the allegedly malicious and unjustified filing of the adversary complaint by Plaintiffs. It, therefore, is deemed to have arisen after the commencement of the bankruptcy

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<sup>11</sup>For example, Code § 523(d) effectively creates a counterclaim in favor of a debtor if an adversary proceeding commenced by a creditor pursuant to Code § 523(a) is not “substantially justified.”

case. Because Defendant's counterclaim is not based on any express Code provision, and a recovery based on the counterclaim would add nothing to Defendant's bankruptcy estate, this Court is without jurisdiction to render a determination regarding the counterclaim. *See* 28 U.S.C. § 157(b). Consequently, the counterclaim must be dismissed and pursued in another forum.<sup>12</sup>

Based on the foregoing, it is hereby

ORDERED that Defendant's motion for summary judgment dismissing Plaintiffs' complaint is granted subject, however, to the condition that both Paine Weber and Prudential are served with a copy of this Memorandum-Decision and Order by the Defendant and neither Paine Weber nor Prudential files a motion to be substituted as plaintiff in this adversary proceeding within forty-five (45) days of service; it is further

ORDERED that Defendant's request to discharge Plaintiffs as creditors in his bankruptcy case and his request for attorneys' fees are denied; it is further

ORDERED that Plaintiffs' cross-motion for summary judgment dismissing Defendant's counterclaim is granted, and Defendant's counterclaim is dismissed without prejudice to Defendant's right to assert his counterclaim in another forum; and it is finally

ORDERED that Plaintiffs' request for costs, disbursements and attorneys' fees is denied.

Dated at Utica, New York

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<sup>12</sup>The Court concludes that no evidentiary basis exists to award costs, disbursements and attorneys' fees as requested in Plaintiffs' cross-motion.

this 13th day of May 2002

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STEPHEN D. GERLING  
Chief U.S. Bankruptcy Judge